

**STATE OF WASHINGTON
OFFICE OF THE INSURANCE
COMMISSIONER**



FINANCIAL EXAMINATION

of

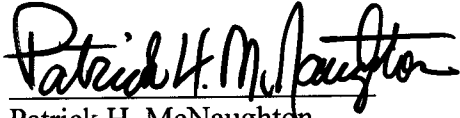
**Community Health Plan of Washington
Seattle, Washington**

**NAIC CODE 47049
DECEMBER 31, 2003**

**Exhibit A
Order No. G05-77**

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify I have read the attached Report of the Financial Examination of Community Health Plan of Washington, Seattle, Washington. This report shows the financial condition and related corporate matters as of December 31, 2003.

A handwritten signature in black ink, reading "Patrick H. McNaughton". The signature is written in a cursive style with a large initial "P" and a long horizontal stroke extending to the right.

Patrick H. McNaughton
Chief Examiner

A handwritten date in black ink, reading "November 28, 2005". The date is written in a cursive style with the month and day clearly legible.

Date

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SALUTATION

Seattle Washington
November 28, 2005

The Honorable Mike Kreidler, Commissioner
Washington State Office of Insurance Commissioner (OIC)
Insurance Building – Capitol Campus
302 14th Avenue NW
Olympia, WA 98504

Dear Commissioner Kreidler:

In accordance with your instructions, and in compliance with the statutory requirements of RCW 48.03.010, an examination was made of the corporate affairs and financial records of

**Community Health Plan of Washington
of
Seattle, Washington**

hereinafter referred to as "CHPW" or the "Company," at the location of its home office, 720 Olive Way, Suite 300, Seattle, WA. This report is respectfully submitted showing the condition of the Company as of December 31, 2003.

SCOPE OF THE EXAMINATION

This examination covers the period January 1, 1999 through December 31, 2003 and comprises a comprehensive review of the books and records of the Company. The examination followed the statutory requirements contained in the Washington Administrative Code (WAC), the Revised Code of Washington (RCW), and the guidelines recommended by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook. The examination included identification and disposition of material transactions and events occurring subsequent to the date of examination that were noted during the examination.

Corporate records, external reference materials, and various aspects of the Company's operating procedures and financial records were reviewed and tested during the course of this examination and are commented upon in the following sections of this report. In addition, the Company's certified public accountant's (CPA's) work papers were reviewed and utilized, where possible, to facilitate efficiency in the examination.

INSTRUCTIONS

The examiners reviewed the Company's filed 2003 NAIC Annual Statement as part of the statutory examination. This review was performed to determine if the Company completed the NAIC Annual Statement in accordance with the NAIC Annual Statement Instructions and to determine if the Company's accounts and records were prepared and maintained in accordance with Title 48 RCW, Title 284 WAC, and the NAIC Statements of Statutory Accounting Principles (SSAP) as contained in the Accounting Practices and Procedures Manual (AP&P).

The following summarizes the exceptions noted while performing this review.

1. Filing of Financial Statements

- a. The Company's 2003 Statement of Actuarial Opinion (SAO) lists \$33,145,411 and \$1,504,430 for Unpaid Claims net of reinsurance, and Unpaid Claims Adjustment Expenses, respectively. These two figures are certified by CHPW's actuary. However, Page 3 of the Company's 2003 NAIC Annual Statement lists \$32,785,410 and \$1,504,448 for Unpaid Claims and Unpaid Claims Adjustment Expenses, respectively. The difference was explained as transposition errors made by the CHPW's staff.
- b. Amounts in the Underwriting and Investment Exhibit Part 2B do not cross-check with the Liabilities, Capital and Surplus Statement as well as the Statement of Revenues and Expenses (Page 3 and Page 4) of the Company's 2003 NAIC Annual Statement as required by the 2003 NAIC Statement Instructions.
- c. A premium rate adjustment was issued by the Medical Assistance Administration (MAA) for its Healthy Options Program in the amount of \$1,411,443 which was received in December of 2003. The premium and related capitation expense was recorded in 2004 as a late adjustment subsequent to the filing of the Company's 2003 NAIC Annual Statement.

The Company is instructed to comply with RCW 48.43.097 and file a true statement of its financial condition, transactions, and affairs which requires the filing of its NAIC Annual Statement in accordance with the NAIC AP&P Manual, and the NAIC Annual Statement Instructions. RCW 48.43.097 states, "Every health carrier holding a registration from the commissioner shall file its financial statements as required by this code and by the commissioner in accordance with the accounting practices and procedures manuals as adopted by the national association of insurance commissioners, unless otherwise provided by law."

2. Furniture, Fixtures and Equipment

The Company did not disclose the amount of depreciation expense for the period as well as a general description of the method used in computing depreciation for furniture and equipment in the audited statutory financial statements for 2003 in accordance with SSAP No.19, paragraph 14 and paragraph 15, respectively.

Pursuant to WAC 284-07-050(2), the Company is instructed to comply with SSAP No. 19, paragraphs 14 and 15 in disclosing the amount of depreciation expense for the period and method(s) of depreciation for furniture and equipment in future audited statutory financial statements.

3. Administrative Service Fees Misclassified

The Company contracts with Community Health Network of Washington (the Network) to provide administrative services to the Company's enrollees. The Company also contracts with the pharmacy vendor, Express Scripts, to provide administrative services for pharmacy claims. Capitation payments to the Network and Express Scripts were booked as medical claims, including payments of administrative fees. SSAP No. 85 requires administrative fees to be recorded as Claims Adjustment Expenses.

Pursuant to WAC 284-07-050(2), the Company is instructed to comply with SSAP No. 85 in reporting administrative services fees related to claims as Claim Adjustment Expenses for future filings.

COMMENTS AND RECOMMENDATIONS

No comments or recommendations were noted based on our examination.

COMPANY PROFILE

Company History

The Company incorporated and commenced business in July of 1996 and currently operates as a nonprofit cooperative association that is licensed as a health care service contractor by OIC. The Company provides health insurance coverage to enrollees of the State of Washington Department of Social and Health Services (DSHS) Medical Assistance Administration's (MAA) Healthy Options (HO) and Children's Health Insurance Program (CHIP) Managed Medicaid programs; the Washington State Health Care Authority (HCA) Basic Health Plan (BHP); and Public Employees Benefits Board (PEBB) programs. Coverage is provided pursuant to global capitation arrangement with the Medical Assistance Administration (MAA) and the Health Care Authority (HCA).

Under the arrangements, services are provided for a certain amount per enrollee per month regardless of the frequency, extent or nature of the services provided to enrollees.

Territory and Plan of Operation

The Company conducts business only in the state of Washington. The Company is licensed as a Health Care Service Contractor and is authorized to issue medical insurance products. CHPW contracts with the Washington State Department of Social and Health Services (DSHS) and the Washington State Health Care Authority (HCA) to issue comprehensive medical plans, which includes Medicaid - Healthy Options (HO), Basic Health Plan (BHP), Public Employees Benefits Board (PEBB), and Children's Health Insurance Program (CHIP). CHPW does not have any commercial business other than the state contracts as mentioned.

Community Health Network of Washington (the Network) is a managed health care delivery network which operates under the direction of 19 member centers. The Network has a global capitation arrangement with CHPW to provide certain health coverage and administrative services to CHPW's enrollees. The Network's health insurance coverage to CHPW's enrollees includes all primary care claims, all hospital claims below \$25,000, HO and BHP pharmacy claims of the member centers, and any specialist claims below \$5,000, plus 10% of specialist claims between \$5,000 and \$25,000 per enrollee per year. CHPW also has a reinsurance agreement with Chubb Executive Risk to limit its losses on claims. CHPW cedes its risk for 90% of hospital claims amounts in excess of \$75,000 per enrollee per year.

Growth of Company

The following schedules reflect the growth of the Company by year beginning in 1999. The amounts shown were compiled from the Company's filed NAIC Annual Statements.

Schedule 1

<u>Year</u>	<u>Admitted Assets</u>	<u>Liabilities</u>	<u>Capital & Surplus</u>
2003	\$124,434,831	\$44,221,502	\$80,213,329
2002	131,370,922	66,269,297	65,101,625
2001	95,009,355	32,205,658	62,803,697
2000	70,105,178	31,871,716	38,233,462
1999	41,525,035	14,901,949	26,623,086

Schedule 2

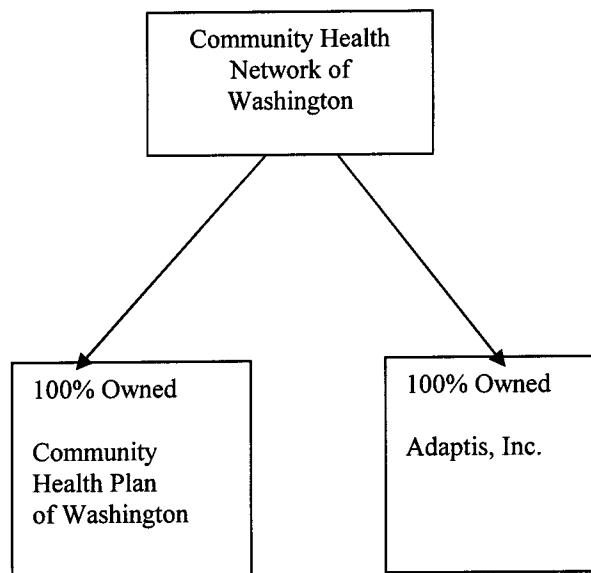
<u>Year</u>	<u>Premiums Earned</u>	<u>Underwriting Deductions</u>	<u>Underwriting Gain or (Loss)</u>	<u>Investment & Other Income</u>	<u>Pre-Tax Income</u>
2003	\$352,991,914	\$302,009,650	\$11,566,428	\$368,476	\$11,934,904
2002	331,347,014	287,433,507	5,091,358	898,844	5,990,202
2001	310,555,186	265,172,300	11,494,274	563,154	12,057,428
2000	240,959,528	218,093,593	5,810,449	3,503,549	9,313,998
1999	143,214,141	125,484,810	2,568,271	442,126	3,010,397

AFFILIATED COMPANIES

The Company is a controlled affiliate of Community Health Network of Washington (the Network), a Washington State nonprofit corporation. The Network operates as a health delivery network under the direction of 19 community and migrant health centers in the state of Washington and is comprised of the clinics operated by these health care centers and other clinics within the Network's service area.

The Network has a global capitation arrangement with the Company to provide certain health insurance coverage and administrative services to the Company's enrollees. The Network's health insurance included all primary care claims, any hospital claims below \$25,000, and any specialist claims below \$5,000, plus 10% of specialist claims between \$5,000 and \$25,000 per enrollee per year. Costs under the terms of this arrangement are reported in medical and hospital benefits.

Organizational Chart



Intercompany Contracts

The Company provides certain administrative functions for the Network under a written paymaster and shared service arrangement. Salary, benefits, and various other operating costs relating to these services are paid by the Company and allocated to the Network.

The Network pays rent under its lease for office space, which is shared by both companies. The Network allocates rent expense to the Company under the terms of the shared service arrangement.

The Network's subsidiary, Adaptis, Inc., has an arrangement with the Company to provide third-party administrative services that include claims processing, provider customer service, eligibility and premium processing and information systems. Payments to Adaptis, Inc., are settled on a monthly basis.

MANAGEMENT AND CONTROL

Board of Directors

<u>Name</u>	<u>Principle Occupation</u>
John Browne	Executive Director, Moses Lake Community Health Center
Malcolm Butler, MD	Medical Director at Columbia Valley Community Health
Darnell Dent	President and CEO, Community Health Plan Washington
David Flentge	Executive Director, Community Health Care
Barbara Malich	CEO at Peninsula Community Health Services
Mark Secord	Executive Director, Puget Sound Neighborhood Health Center
Peter Toop	Finance Manager at Yakima Valley Farmworkers Clinic
Thomas Trompeter	Executive Director, Community Health Center of King County
Shakti Matta, MD	Medical Director, Columbia Basin Health Association

Officers

<u>Name</u>	<u>Title</u>
Darnell Dent	President and CEO
Thomas James Trompeter	Secretary
Peter Klaus Toop	Treasurer

Conflict of Interest

Officers, directors, and key employees are required to make yearly declarations in regards to conflicts of interest. There is a code of conduct in effect for all employees of CHPW. Any potential conflicts are investigated by the Assistant Vice President of Compliance and Risk Management and then brought up to the Board of Directors.

Fidelity Bond and Other Insurance

The Company has fidelity insurance in the amount of \$5,000,000 which is well above the minimum required by NAIC guidelines \$1,000,000 to \$1,250,000. The Company also has a program of coverage for professional liability, directors and officers liability and casualty excess.

Officer's, Employees', and Agents' Welfare and Pension Plans

The Company does not have a defined pension plan. The Company participates through Community Health Network of Washington's defined contribution and profit sharing retirement savings plan pursuant to section 401(k) of the Internal Revenue Code which covers all employees who meet certain eligibility requirements.

CORPORATE RECORDS

CHPW incorporated and commenced business in July of 1996 and currently operates as a nonprofit cooperative association that is licensed as a health care service contractor by the OIC. CHPW contracts with DSHS and HCA to issue comprehensive medical plans, which includes Medicaid - Healthy Options (HO), Basic Health Plan (BHP), Public Employees Benefits Board (PEBB), and Children's Health Insurance Program (CHIP). CHPW does not have any commercial business other than the state contracts as mentioned.

No amendments to the Articles of Incorporation or Bylaws occurred during the examination period. The minutes of the meetings of stockholders, directors, and committees adequately document appropriate approvals and support the Company's transactions and events.

LOSS EXPERIENCE

The Company's actuarial report claims unpaid, and other claim liabilities as December 31, 2003, were reviewed by the OIC actuary. This review included: examining the Company's reserving philosophy and methodologies to determine the reasonableness of the claim liabilities, verifying that claims liabilities included provisions for all components noted in the NAIC Accounting Practices and Procedures Manual, reviewing historical paid claims and loss ratios, checking the consistency of the incurred-paid data reported in the Company's NAIC Annual Statements, and estimating claims unpaid for the valuation date of December 31, 2003.

In addition to the above, the OIC actuary examined the unpaid claims liabilities of CHPW's parent company, Community Health Network of Washington, because of the unique contractual requirements between CHPW and its parent company. CHPW does

not immediately reimburse the Network for paid claims that exceed the retained risk limits. The retained risk liabilities are paid by CHPW to the Network according to a set schedule: 75% distribution on the eighth month after the end of the contract period (August), 15% distribution on the fourteenth month after the end of the contract period (February), and 10% distribution on the seventeenth month after the end of the contract period (May). Therefore, for the contract year 2003, claims above the retained risk which CHPW owed to the Network were not paid until August 2004. For the pharmacy claims, the Network is responsible for the HO and BHP member center pharmacy claims, and CHPW is responsible for all other pharmacy claims.

Because CHPW's ability to pay claims is heavily dependent upon the solvency of the Network, the Network's unpaid claims reserving philosophy and methodologies were examined and an independent estimate computed. The Network has sufficient reserves for the unpaid claims based on the reserving philosophy and methodologies examined and estimates computed. The 2003 overall loss ratio according to Page 7 of the 2003 NAIC Annual Statement is 85.6%. The 2003 net underwriting gains are \$11,566,427.

The history of the claim liability adequacies and the work of the consulting actuary who estimated the claim liabilities, based on the 2002 and 2003 NAIC Annual Statements were reviewed. Actual claim liabilities were noted as conservative and had positive margins or redundancies. In the 2003 NAIC Annual Statement, the Company booked \$32,785,410 for claims unpaid as of December 31, 2003. The Company's 2003 Statement of Actuarial Opinion (SAO) listed \$33,145,411 for claims unpaid certified by CHPW's actuary. The difference was explained as transposition errors made by the CHPW's staff. The work papers provided by the Company's consulting actuary were reviewed and the methodology and reserves were found to be reasonable, and one of the methods prescribed by the American Academy of Actuaries.

REINSURANCE

The Company ceded reinsurance to limit its losses on certain claims. Under the terms of the agreement, the Company ceded its risk for 90% of hospital inpatient claim amounts in excess of \$75,000 per enrollee per year. For the reinsurance agreement between Chubb Executive Risk and CHPW, when a claimant exceeds the reinsurance threshold, CHPW submits a bill to the reinsurer. The reinsurance contract specifically states that the reinsurer shall not be liable for any claim for which the notice is given more than 210 days after the expiration date of the policy period. Therefore, CHPW could receive the reinsurance payment from Chubb before it pays the retained risk liability to the Network.

STATUTORY DEPOSITS

As of December 31, 2003, the Company had an indemnity deposit with Wells Fargo Institutional Trust with a par value of \$285,000 and market value of \$185,347.

ACCOUNTING RECORDS AND INFORMATION SYSTEMS

The Company maintains its accounting records on a modified Generally Accepted Accounting Principles (GAAP) accrual basis of accounting and adjusts to Statutory Accounting Practices (SAP) basis for NAIC Annual Statement reporting. The Company is audited annually by the certified public accounting firm of Ernst & Young LLP. The Company received an unqualified opinion for all years under review. The Company's accounting procedures, internal controls, and transaction cycles were reviewed during the planning and testing phase of the examination and no exceptions were noted.

The management of the Company is sufficiently knowledgeable of the information systems (IS) process. Systems development, acquisition, and maintenance controls were evaluated to gain assurance that appropriate controls are in place. Operations and application controls were reviewed to determine the type of hardware installed; operating systems and proprietary software in use; back up and recovery facilities employed; and the controls exercised to maintain data security. Sufficient internal controls are in place and monitored by the Company. The Company's IS Department has the ability to recover from an incident or disaster and has documented these procedures in a detailed, written disaster recovery plan.

SUBSEQUENT EVENTS

The Company requested approval from OIC to pay an ordinary distribution of excess surplus funds to Community Health Network of Washington (CHNW) totaling \$5,921,038 on February 27, 2004. The request was accepted as filed per notification by the OIC. Payment of this distribution was made during the second quarter of 2004. The approved capital distribution of \$5,921,038 was reflected as a reduction in the capital and surplus account in 2004.

In December 2004, CHPW requested and received approval from the OIC to pay an extraordinary distribution of excess surplus funds to CHNW totaling \$12,900,000 which was paid in February 2005.

Effective December 1, 2004, CHPW entered into a contract with the Department of Social and Health Services for the 2004 General Assistance Unemployable (GAU) Managed Care Pilot Project. CHPW enrolled members under this new program contract were approximately 3,000 members in December 2004 and 2,200 members in January

2005. Premiums received from DSHS in December 2004 for the GAU pilot were approximately \$550,000, which represents \$156.90 per member per month in King County and \$217.63 per member per month in Pierce County.

Effective January 1, 2005, CHPW plans to contract with a new reinsurer, an A+ rated Lloyd's syndicate. Presidio Excess Insurance Services will be the Managing General Underwriter. The coverage and terms of the reinsurance contract are the same as CHPW's 2003 and 2004 reinsurance contract with CHUBB. CHPW will continue to cede 90% of hospital claim amounts in excess of \$75,000 per enrollee per year.

FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS

All previous report instructions and comments have been addressed by the Company.

FINANCIAL STATEMENTS

The following examination financial statements show the financial condition of Community Health Plan of Washington as of December 31, 2003

Statement of Assets and Liabilities, Capital and Surplus
Statement of Revenue and Expenses
Five Year Reconciliation of Surplus

**COMMUNITY HEALTH PLAN OF WASHINGTON
ASSETS, LIABILITIES, CAPITAL AND SURPLUS
DECEMBER 31, 2003**

	BALANCE PER COMPANY	REF	EXAM ADJUSTMENT	BALANCE PER EXAM
Assets				
Bonds	\$39,677,056			\$39,677,056
Common Stock	25,176,286			25,176,286
Cash and short-term investments	52,613,542			52,613,542
Subtotal, cash and invested assets	117,466,884		\$0	117,466,884
Investment income due and accrued	938,227			938,227
Premiums and considerations:				
Uncollected premiums and agent's balances in the course of collection	2,678,641			2,678,641
Amounts recoverable from reinsurers	3,070,086			3,070,086
EDP equipment and software	224,792			224,792
Receivables from parent, subsidiaries, and affiliates	56,201			56,201
Total assets	124,434,831		0	124,434,831
Liabilities, Capital and Surplus				
Claims unpaid	32,785,410			32,785,410
Unpaid claims adjustment expense	1,504,448			1,504,448
General expenses due or accrued	3,730,468			3,730,468
Ceded reinsurance premiums payable	39,111			39,111
Borrowed money	6,162,065			6,162,065
Total Liabilities	44,221,502			44,221,502
Gross paid in and contributed surplus	33,559,486			33,559,486
Aggregate write-ins for other than special surplus funds	150,000			150,000
Unassigned funds (surplus)	46,503,843			46,503,843
Total capital and surplus	80,213,329			80,213,329
Total Liabilities, capital and surplus	\$124,434,831		\$0	\$124,434,831

**COMMUNITY HEALTH PLAN OF WASHINGTON
STATEMENT OF REVENUE AND EXPENSES
DECEMBER 31, 2003**

	BALANCE PER COMPANY	REF	EXAM ADJUSTMENT	BALANCE PER EXAM
Member months	2,391,712			2,391,712
Net premium income	\$352,991,914		\$0	\$352,991,914
Total revenues	352,991,914			352,991,914
Hospital and Medical:				
Hospital/medical benefits	299,913,247			299,913,247
Prescription Drugs	9,478,407			9,478,407
Subtotal:	309,391,654			309,391,654
Less:				
Net reinsurance recoveries	7,382,004			7,382,004
Total medical and hospital	302,009,650			302,009,650
Claim adjustment expenses	4,941,014			4,941,014
General administrative expenses	34,474,822			34,474,822
Total underwriting deductions	341,425,486			341,425,486
Net underwriting gain or loss	11,566,428			11,566,428
Net investment income earned	1,700,605			1,700,605
Net realized capital gains or (losses)	(1,343,448)			(1,343,448)
Net investment gains or (losses)	357,157			357,157
Aggregate write-ins for other income or expenses	11,319			11,319
Net income (loss)	\$11,934,904		\$0	\$11,934,904
CAPITAL AND SURPLUS ACCOUNT				
Capital and surplus prior-reporting period	\$65,101,625			\$65,101,625
Net income or (loss)	11,934,904			11,934,904
Net unrealized capital gains and losses	8,428,163			8,428,163
Change in nonadmitted assets	910,702			910,702
Change in surplus notes	(6,162,065)			(6,162,065)
Net change in capital and surplus	15,111,704			15,111,704
Capital and surplus end of reporting year	\$80,213,329		\$0	\$80,213,329

**COMMUNITY HEALTH PLAN OF WASHINGTON
FIVE YEAR RECONCILIATION OF SURPLUS
FOR THE YEARS ENDED DECEMBER 31,**

	<u>2003</u>	<u>2002</u>	<u>2001</u>	<u>2000</u>	<u>1999</u>
Capital and surplus, December 31, previous	<u>\$65,101,625</u>	<u>\$62,803,697</u>	<u>\$38,233,462</u>	<u>\$26,623,086</u>	<u>\$ 16,119,946</u>
Net income	11,934,904	6,511,836	15,287,494	6,227,892	2,318,949
Net unrealized capital gains or (losses)	8,428,163	(4,204,234)	(1,778,857)	(1,689,599)	2,780,629
Change in nonadmitted assets	910,702	(9,674)	(938,402)	(365,971)	(399,521)
Change in surplus notes	(6,162,065)				1,669,131
Capital contribution			12,000,000	7,438,054	4,133,952
Change in surplus as regards policyholders for the year	<u>15,111,704</u>	<u>2,297,928</u>	<u>24,570,235</u>	<u>11,610,376</u>	<u>10,503,140</u>
Surplus as regards policyholders, December 31, current year	<u>\$80,213,329</u>	<u>\$65,101,625</u>	<u>\$62,803,697</u>	<u>\$38,233,462</u>	<u>\$26,623,086</u>

NOTES TO THE FINANCIAL STATEMENTS

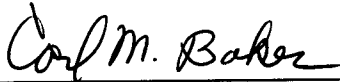
The Company has no special consents, permitted practices or orders from the state of Washington and there were no examination adjustments.

ACKNOWLEDGMENT

Acknowledgment is hereby made of the cooperation extended to the examiners by the officers of Community Health Plan of Washington during the course of this examination.

In addition to the undersigned, Michael Jordon, CPA, CFE, MHP, Assistant Chief Examiner; John Jacobson, AFE, CISA, IS Specialist; John Gaynard, CPA, CFE, CPCU, Reinsurance Specialist; Mike Bosley, CPA, Financial Examiner; Juanita Turley, CPA, Financial Examiner and Lichiou Lee, ASA, MAAA, Health Actuary all from the Washington State Office of the Insurance Commissioner, participated in the examination and the preparation of this report.

Respectfully submitted,

A handwritten signature in cursive script that reads "Carl M. Baker". The signature is written in dark ink and is positioned above a horizontal line.

Carl M. Baker, CPA, CISA, CFE
Examiner-in-Charge
State of Washington

AFFIDAVIT

STATE OF WASHINGTON

}

} ss

COUNTY OF KING

}

Carl M. Baker, being duly sworn, deposes and says that the foregoing report subscribed is true to the best of his knowledge and belief.

He attests that the examination of Community Health Plan of Washington was performed in a manner consistent with the standards and procedures required or prescribed by the Washington State Office of the Insurance Commissioner and the National Association of Insurance Commissioners (NAIC).

Carl M. Baker

Carl M. Baker, CPA, CISA, CFE
Examiner-in-Charge
State of Washington

Subscribed and sworn to before me this 28th day of November, 2005.

Colleen Jansen

Notary Public in and for the
State of Washington.

